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CORPORATE AMERICA'S MAGAZINE

BUSINESS MONTH

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APRIL 1987 $3.00

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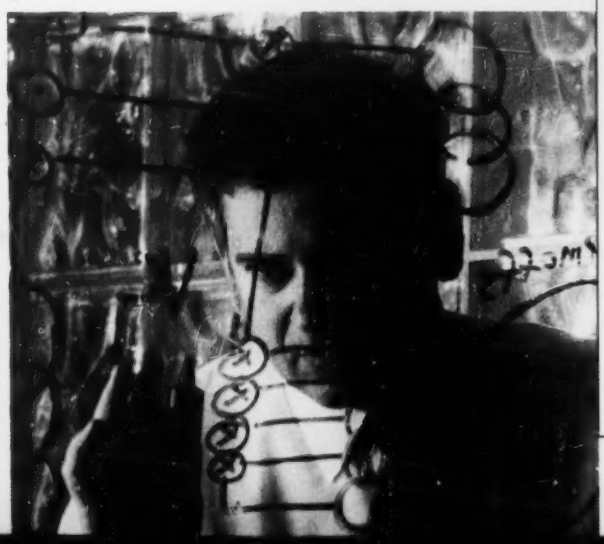

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Why the Banks Are in a Bind

Their loan business is shrinking fast and entry into new areas is circumscribed. Where will the profits come from?

by Leah Nathans

Walter Wriston, 67, former chairman of Citicorp, recalls that Arthur Burns, the chairman of the Federal Reserve Board from 1970 to 1978, viewed banks as government-supported monopolies that could not preserve the safety of the system and also make money. Last year, the two met again after appearing on a French television program. Acknowledging that the world has changed, the 82-year-old Burns said, Walter, you were right about banks having to earn money.

Headlines scream with the woes of money-center banks burdened with massive Brazilian debt, shotgun mergers of Texas banks, and the most bank failures since the Great Depression. What they don't reveal is that the real threat to bank safety and soundness is the long-term decline in their profits. "Bank profits are at their lowest point in fifteen years," says Comptroller of the Currency Robert L. Clarke. Adds John F. Ruffle, vice chairman of the board of J.P. Morgan & Co., "There's a strong need for profits. That's what's hurting the banking system."

Profits have been steadily eroding. From 1981 to the third quarter of 1986, return on assets for all banks dropped from .76% to .68%. Since 1980, the banks' share of all financial assets has fallen from 35% to 32% at the end of 1985. "The industry is on a downward trend," worries Comptroller Clarke. "It's a problem that deserves immediate attention."

Victims of structural changes in the U.S. economy, a tattered, crazy quilt of outdated banking regulations and new rivals for its shrinking market share, banks no longer enjoy monopoly status and the luxurious margins that go with it. The value of a bank franchise is declining, bankers grumble.

New financial products that turn assets into securities, such as mortgage-backed paper or certificates of automobile receivables, are cutting out the banks' traditional role as middlemen. Ask J. Terrence Murray, president and CEO of Fleet Financial Group Inc., 1986's top performing regional, who are his main competitors? He answers: Beneficial Finance, Citicorp, General Motors Acceptance Corp. and Bank of New England.

The influx of new rivals and increased competition have dragged down profitability in the industry. But the impact on money-center banks, regionals and small banks has varied enormously. Here is a rundown:

BIG BANKS

The health of the nation's largest banks runs the gamut from the troubled Bank of America to triple A-rated J.P. Morgan & Co. ("Where the Money-Center Banks Stood in 1986," *page 36).* As a group, their returns on equity have fallen steadily. Between 1980 and 1985, ROE dropped from 14.4% to 9.6%, according to the Federal Reserve.

These banks share a core business in wholesale lending, and so have been hard hit by the structural trends. Having lost their exclusive relationship with corporate America, which now raises its short-term funds in the commercial paper market, their wholesale lending business has gone the way of the buggy whip. Most dramatic has been the drop in commercial and industrial lending, which the Fed estimates has slipped from 43% to 27% from 1974 to 1985.

Riskier loans and off balance sheet items have taken up the slack, but the grim decline in asset quality tells the real story. The ratio of net charge-offs as a percent of loans has doubled since 1981. The problem-plagued outlook for the big banks just caused Moody's Investors Services, the watchdog of credit quality, to downgrade Chase Manhattan. "Reduced asset quality is a permanent industry feature," says Moody's analyst Christopher T. Mahoney.

Bankers claim they had no choice but to take on riskier loans. "Where could we continue to make loans at a positive spread? Real estate, energy or go abroad. It's a competitive trap," says George J. Vojta, executive vice president of Bankers Trust.

In the pursuit of profits, they have played the markets. In 1986, 40% of the banks' earnings came from nonlending income, with the biggest growth in securities gains, foreign exchange and bond trading. "We are forced to go into business activities that are perceived as more risky," says J.P. Morgan's Ruffle.

But analysts are skeptical about these strategies. "There's not a lot of confidence that they can put together viable capital markets strategies alternative to basic banking," says David C. Cates, head of Cates Consulting Analysts, Inc. Adds Moody's Mahoney: "New businesses are not an adequate substitute for what they've lost. There's no such oligopoly aspect to them."

One reason: These earnings are far more volatile than profits from traditional lending. As a result, many analysts and regulators label them nonrecurring income. "Securities gains have taken place in a very unusual market when interest rates were headed down. We can't expect that to continue," says Comptroller Clarke.

The legal limitations against selling investment banking, consumer finance and insurance products have big banks champing at the bit. Chase Manhattan's president Thomas G. Labrecque has threatened to give up the bank's federal charter. Without the power to compete, "a bank charter begins to look more and more like a one-way ticket to the graveyard."

ILLUSTRATIONS BY GEOFFREY MOSS

REGIONAL BANKS

The regional banks' profitability picture is nowhere as grim as that of their bigger brothers ("The Super Regionals," *page 36*). By avoiding Third World debt and retaining their bread-and-butter middle market corporate borrowers, their profitability has held fairly steady since 1979. In 1986, New England and Southeast regionals turned in record earnings. "The widget maker in Cleveland doesn't have access to the Euromarket. He wants to walk across the street and do business with a bank," says James J. McDermott Jr., research director of bank specialists Keefe, Bruyette & Woods, Inc.

But interstate banking, in the form of regional compacts in over 38 states, now allow banks to aquire other banks in neighboring states. The result is a climate of intense competition and consolidation.

As their bank competitors offer more sophisticated products and services, their rate of earnings growth could slow. They may lose some of their middle market borrowers, who are potential issuers of commercial paper, junk bonds and other exotics that regionals are not providing.

Aware of the threat, the best-heeled regionals are rapidly diversifying out of high-cost lending operations into new products such as consumer finance and mortgage and mutual fund processing.

The main challenge is to avoid the Bank of America syndrome—that is, management unwillingness to wield the cost-cutting axe on its far-flung empire. Highly dependent on expensive consumer businesses, their future profitability will hinge on their willingness to downsize and enter new lower-cost businesses.

COMMUNITY BANKS

Thanks to a dismal farm economy, a boom and bust energy cycle and plain poor management, at year-end 1985 profits at the 13,528 banks with assets under $300 million have declined more

THE CRISES CAN BE CONTAINED

Just how dangerous are the industry's woes? Judging from the screaming headlines, the banking industry is beset by impending catastrophes that threaten to collapse the entire system. Without question, some of these problems are so grave that, like nuclear war, they are too dreadful to contemplate.

But as Continental Illinois' plight in 1984 demonstrated , the public watchdogs, from the International Monetary Fund and Congress to the Federal Reserve Board, are expected to move heaven and earth to keep them from destroying the banking system. Moreover, some scare headlines are unjustified. Bank failure statistics and farm bank horror stories grossly exaggerate the threat to the system.

The massive load of more than $100 billion in Third World debt is the greatest threat to bank solvency for the giant money-center banks. If Brazil, Mexico, Ecuador, Argentina and so forth stopped paying, the writeoffs would wipe out the net worth of the eight largest money-center institutions in one swoop *(right,* "Where The Money-Center Banks Stood in 1986"*)*.

But since 1982, when the money-centers began recycling petrodollars to the Third World, the banks have cut their exposure by beefing up their loan-loss reserves. "It's not a life-threatening problem," says James J. McDermott Jr., director of research for Keefe, Bruyette & Woods, Inc.

Nevertheless, the consensus is that the implications of a widespread default are still so dire that the IMF, the World Bank and the Fed will see to it that it is avoided at almost any cost. Adds McDermott, "It's a very big, complex problem that a lot of people are working on."

Next in urgency is the plight of the savings and loans. The Federal Savings and Loan Insurance Corp., the insurance fund that guarantees the $900 million in S&L deposits, is broke. Estimates of the deficits of insolvent S&Ls vary from $3 billion if the loans are figured at original value to $30 billion at market value . Moreover, Robert Chaut, a thrift analyst at Salomon Brothers, estimates that "20% of the institutions are dead and should be closed."

Texas S&Ls are probably the worst off in the nation. Anecdotes abound of loan officers who wrote loans for amounts greater than the value of a property to pump up results. Instead, the energy economy went into a tailspin. "There is a

WHERE THE MONEY-CENTER BANKS STOOD IN 1986

Boosted by noninterest income, money center bank performance looks healthy. But the Third World debt burden and unimpressive reserves have hurt credit ratings.

	Return on Average Assets	Return on Average Equity	Assets (billions)	Reserves/ Non-performing Loans	LDC Loans/ Net-worth	Non-interest Income/ Total Income 1980	1986	S&P Rating
J.P. Morgan	1.19%	18.9%	$76.0	144%	104%	35%	46%	AAA
Bankers Trust	.79	16.5	56.4	63	124	11	49	AA+
First Chicago	.71	13.4	39.1	68	120	39	44	A+
Chemical New York	.70	14.2	60.6	46	161	20	34	AA
Chase Manhattan	.65	13.1	94.8	54	190	27	27	AA
Citicorp	.57	13.8	196.1	60	144	31	40	AA
Manufacturers Hanover	.54	12.1	74.4	45	222	20	39	A+
BankAmerica	-.47	-16.1	104.2	48	194	22	38	BBB

THE SUPER REGIONALS

Without Third World debt woes, the regionals are turning in robust results. The seemingly low reserve levels are appropriate to their high quality loans.

Ten Largest Regional Banks Year-end 1986	Assets (billions)	Return on Average Equity	Return on Average Assets	Reserves/ Non-performing Loans	Net Chargeoffs/ Loans	S&P Rating
Security Pacific	$62.6	15.5%	0.71%	37%	0.89%	AA+
First Interstate	55.4	13.0	0.68	38	1.18	AA
Wells Fargo	44.6	15.8	0.73	28	0.73	AA-
Bank of Boston	34.1	15.5	0.78	31	0.59	AA
First Bank System	28.0	16.0	0.76	116	2.63	AA-
NCNB Corp	27.5	16.9	0.84	41	0.66	A
First Union Corp.	26.8	20.2	1.30	37	0.49	A+
SunTrust Banks	26.2	17.0	1.03	64	0.63	AA
Marine Midland Banks	24.8	12.1	0.65	28	0.89	A+
Bank of New England	22.5	17.6	0.92	25	0.31	A+

THE TEXAS BANKS

An overload of bad energy and real estate loans is wreaking havoc on the performance and credit ratings of the Lone Star State banks.

Six Largest Texas Banks Year-End 1986	Assets (billions)	Return on Average Assets	Return on Average Equity	Non-performing Loans/ Total Loans	Non-performing Loans/ Equity	Reserves/ Non-performing Loans	S&P Rating
M Corp	$21.9	-0.4%	-8.9%	7.6%	100%	38%	BBB+
** **RepublicBank**	20.9	0.3	4.1	5.7	70	30	A
* **Texas Commerce**	19.2	0.1	1.7	7.3	83	24	A
** **InterFirst**	18.0	-1.7	-32.2	8.2	129	51	B+
First City Bancorp	13.7	-2.4	-54.4	8.8	160	53	B-
Allied Bancshares	9.9	-0.2	-2.7	6.5	69	60	BBB

* Texas Commerce acquired by Chemical New York
** RepublicBank and InterFirst merged via a $570 million stock swap creating the largest bank in the state.
Source: Cates Consulting Analysts, Donaldson, Lufkin & Jenrette, Value Line

black hole with at least $75 billion in bad assets in Texas that could swallow the industry," says a high-level regulator.

But the regulators and Congress won't let this happen. As CEO James Montgomery of Great Western Bank says, "The Treasury has a real interest in making sure the public's confidence in the system does not get to a crisis level."

Congress is already working on a cash transfusion for FSLIC ("Congress Balks at Helping the Banks," *page 43*). With these funds, FSLIC can speed the absorption of the insolvent S&Ls by stronger ones or by commercial banks. In the longer term, there will likely be a merger of the weakened FSLIC with the Federal Deposit Insurance Corp. After that, the S&Ls as a separate industry devoted to mortgage lending will cease to exist. "It certainly looks like we are headed for one industry," Montgomery confirms.

For most of 1986, the Lone Star State lived in fear of a full-fledged bank run. Plummeting oil prices and soaring home foreclosures and office vacancies compelled depositors to pull their funds out of Texas and other Southwest banks. During the year, the FDIC pumped $214 million into the state's ailing banks (*opposite*, "The Texas Banks").

But with the turnaround in crude prices this winter and Chemical Bank and RepublicBank's buyout of two ailing Texas banks, the danger appeared to subside. Still, the banks are not out of the woods. Nonperforming real estate loans, which comprise an average 18% of the six top banks' loan portfolios, have the regulators worried and more mergers are probably in the cards. Even so, the regulators are expected to continue to prop up the large Texas banks, like the still-ailing First City of Houston, because they are just too big to let fail.

Yes, 138 banks failed last year, the largest number since the Depression. But the reality is 95% of them were pretty small potatoes.

As painful as each collapse may be to the individuals and communities, Dana H. Cook, a troubleshooter for the Comptroller, observes proudly that only five of the 138 left a town without banking services. And when the Texas native tried to locate the whereabouts of three of them that were located in towns of less than 500 souls, he says, "I could not find them on a map."

The overall impact is like a flea bite on the system—a difficult but manageable phenomenon that the FDIC is strong enough to handle.

Almost half of these bank failures were in the Farm Belt. The troubles plaguing America's farmers, however, are not hurting the banking system for a number of reasons. Most farm debt is not even held by the banks. Of the $188 billion in total farm debt at the end of 1986, banks held only $44.1 billion, or 23.5% of the total; the majority was held by the federal government. Moreover, explains Emanuel Melichar, the Federal Reserve Board economist who monitors farm bank debt, "Farm loans are only a small proportion of total loans and agricultural banks account for only a small share of total banking resources."

Therefore, only a minority of farm banks are financially under water. Most of the failures, charge-offs and nonperforming loans are accounted for by only one-third of farm banks.

Meanwhile, farm profit margins have firmed and the farmers are not "spending their earnings as much as using them to pay off debt," notes Stanley L. Graham, economist at the Federal Reserve Bank of Minneapolis. As a result, farm debt has been declining since the summer of 1983. In fact, says Melichar, "Small but positive retained earnings were added to capital in both 1985 and 1986." —Leah Nathans, Lynn Adkins and David Kiley

than any other category. And their inability to diversify their sources of income will keep them vulnerable. Meanwhile, the spread small banks earn has declined almost 10% since 1979.

Analysts expect that poorest performers reckoned at one-third of these banks will be swallowed up by better managed diversified institutions. "Their earnings outlook is so indifferent, they would be better off seeking outside management," says Cates.

The one-third that nobody wants will limp along serving very small markets. The remaining third are viable survivors because they are well-managed and will adapt. But the license to sell real estate, insurance and mutual funds to the average citizen is critical to be competitive. "They need to have powers to compete with Sears and do what a non-bank can do," says Chairman L. William Seidman of the Federal Deposit Insurance Corp.

If the present trend continues, by 1990 there could be 20% fewer commercial banks in the U.S. and their share of all financial assets would fall from 32% to 29%. No wonder bankers of all sizes have descended on the nation's capital in an intense push for nothing less than a comprehensive rethinking of the banking system's fundamental structure.

Ironically, in an about-face from Arthur Burns' days, their strongest supporter in Washington is the Fed. Chairman Paul Volcker has called for new powers to let banks enter non-bank businesses—a huge change for the hide-bound central bank.

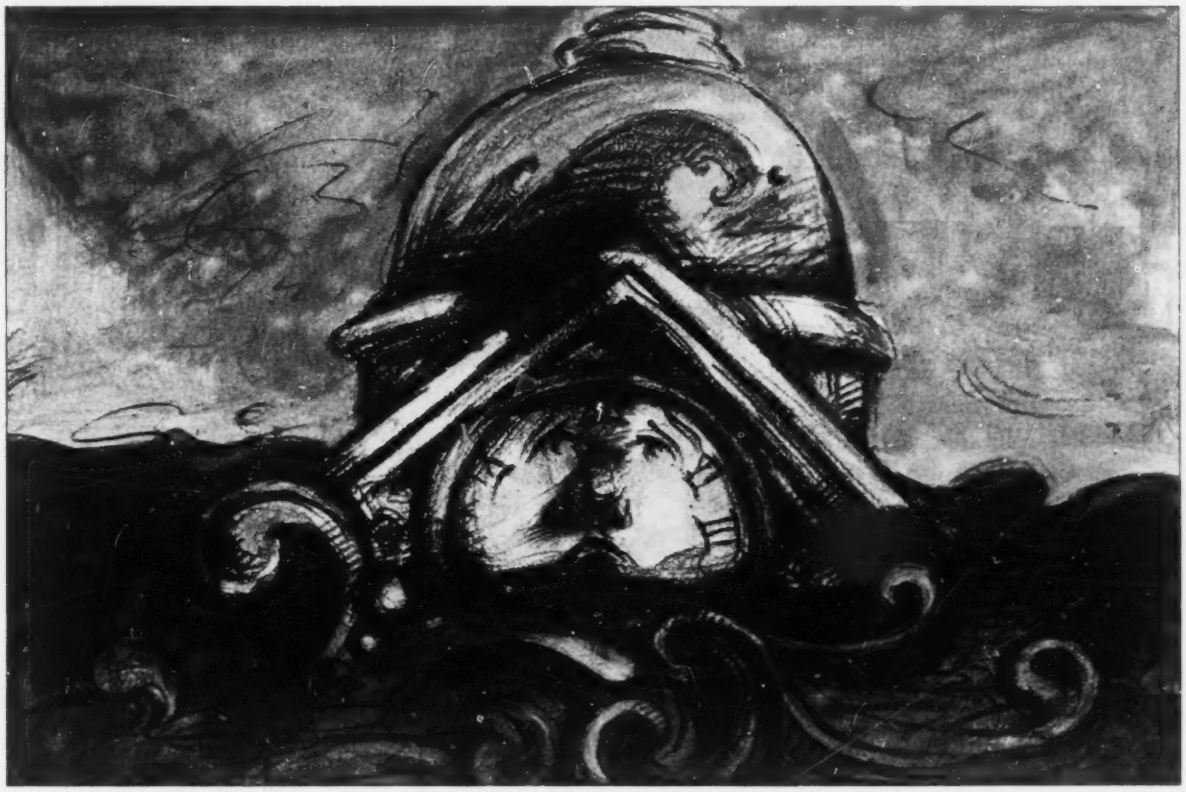
But the power to bring about major reform resides with Congress, and to date the House and Senate have hidden in a dark corner. Fumes one angry banker: "Those guys will never muster the courage to legislate radical changes in banking until it's too late." If so, adds President Mark Olsen of the American Bankers Association, "There's no question that without the ability to compete, the banking industry's share of the total financial marketplace will continue to erode." ■

INTERNATIONAL
SPECIAL REPORT

The Bleak Picture Abroad

The U.S. banks' share of the international market is falling fast. The Japanese are coming on strong.

by David Fairlamb



Just as the U.S. banks are in trouble at home, they face increasing difficulties abroad. Hobbled by a weak dollar and high costs, they are losing business at a fast clip to European and Japanese rivals. In only two years, their share of the international commercial banking market slipped from more than one-quarter to less than one-fifth in 1986 *(table, page 42)*.

Lackluster performance has forced smaller banks such as Indiana National and First Pennsylvania to shut up shop and go home. And even mighty Citicorp has been beating a retreat (although the company would probably deny it). A couple of years ago, Citi seemed unstoppable in leading European markets and poised for a major breakthrough in Japan. But it recently closed four offices in Germany and is rumored to be considering the sale of its forty retail branches in Britain. Moreover, bank analysts say its performance in the recently deregulated London capital markets has been unimpressive and that its Japanese opera-

tions have not lived up to expectations.

By contrast, the supercompetitive Japanese banks have increased their market share dramatically and now account for almost one-third of the international market. Indeed, the Bank of England estimates that the Japanese now have a 36% share of the critical London market, compared with the American banks' 15%. "The most outstanding feature of the past ten years has been the growth of the Japanese banks at the expense of the U.S. institutions," says Bank of England economist Paul Wright.

Unrestricted abroad by the regulations that bar them from investment banking activities at home, the U.S. banks compete on an equal footing with the European universal banks and the Japanese giants (which are also barred from securities operations in their domestic market). And all the banks are being hit by the dwindling demand for traditional bank loans from international companies, which can now borrow more cheaply by tapping the commercial paper markets. "I tell [the banks] don't call us, we'll call you," quips Christopher Bull, finance director of British Telecom plc.

Given the weak dollar and towering U.S. trade deficit, however, American banks have less money at their disposal than their foreign rivals. The big Japanese and German balance-of-payments surpluses, coupled with the strong yen and even stronger mark, have transferred huge amounts of dollars to their banks. In contrast, the U.S. deficit, along with the sharp reduction in Middle East oil money traditionally recycled through American banks, has limited the supply of funds available to the U.S. institutions. Besides that, of course, the weak dollar has boosted the assets of the foreign banks at the expense of the U.S. banks *(table, right)*.

Beyond these international economic factors, what has primarily blunted the U.S. banks' competitive edge is their relatively high cost of borrowing. Example: A prime American bank raises money at 6.3% by issuing certificates of deposit in the U.S. or tapping the interbank market in London; on top of that, it must add 30 basis points for reserve requirements and insurance, 5 points to cover loan loss reserves and 110 points in equity costs. That all adds up to 7.75%—before taking into account relatively high overhead expenses such as salaries and dividends.

In contrast, analysts calculate that a top German bank can pay as little as 4% to raise deutschemark funds, swap them into dollars and end up paying less than 6% for its money; and a comparable Japanese bank could get the money for as little as 5.9%. Besides that, Japanese and most European banks are required to maintain lower capital-to-loan ratios than the American banks, which means that they can achieve a reasonable return on equity on lower-margin business.

At the same time, the American banks' high ratio of domestic and Third World problem loans has lowered their credit ratings. Moody's downgraded the credit ratings of 39 American banks last year. For example, Moody's recently gave a $100 million Eurobond issued by Dai-Ichi Kangyo Bank an Aaa rating, while First Chicago was given a much lower A3 for a $121 million float-

A SHRINKING BASE

Only one U.S. bank, Citicorp, now ranks among the world's ten largest banks. Meanwhile, other major U.S. banks have fallen in world ranking.

Dai-Ichi Kangyo	Japan	$213.3*
Citicorp	U.S.	196.1
Fuji	Japan	182.5*
Sumitomo	Japan	179.1*
Mitsubishi	Japan	174.2*
Sanwa	Japan	167.9*
Credit Agricole	France	149.8**
Banque Nationale De Paris	France	142.8**
Credit Lyonnais*	France	131.5**
National Westminster	U.K.	125.0

*For fiscal year ended March 31, 1986.
**For year ending June 30, 1986.
Exchange rates: 160 yen = $1; 6.20 francs = $1; £1.50 = $1.

Citicorp	2	2
BankAmerica	18	1
Chase Manhattan	22	15
J. P. Morgan	33	30
Manufacturers Hanover	34	21
Security Pacific	44	40
Chemical New York	48	44
Bankers Trust	49	45
First Interstate	55	46
Wells Fargo	66	65

Source: The Banker. *Estimated.

ing-rate note; and a 500 million-franc Eurobond issue by Credit National of France got an AAA rating from Standard & Poor's, while a Citicorp $500 million issue got only an A+.

This disparity allows Japanese and European banks to raise money more cheaply on the international bond markets and undercut U.S. banks on many deals, including some from American corporations. When Marriott Corp.'s Marriott/Portman Capital subsidiary sought $375 million late last year, it chose France's Credit Lyonnais and three Japanese banks as lead managers. Likewise, Dayton Hudson Corp. appointed Swiss Bank Corp. International to lead-manage a recent $100 million financing. "U.S. banks are no longer the natural intermediaries between their corporate clients and the international markets," says chief economist David Kern of Britain's National Westminster Bank plc.

Even in loan syndications lead-managed by American banks, Japanese and European banks are increasingly providing the lion's share of the money. In a recent $350 million deal for the Republic of Indonesia led by Chase Manhattan's Asian operation, half the banks that participated were Japanese, and they provided four-fifths of the money. "Nowadays, you rarely see a tombstone without a Japanese name on it," comments London financial analyst Stefan Mendelsohn. "They have sufficient volume to bid for whatever business they want on whatever terms they want."

At the same time, Japanese and European banks have benefited from the rapid growth of the Euroyen and Eurodeutschemark markets and the consequent decline in the dollar's preeminence in international financings (*table, below*). Many American companies are now dabbling in foreign currencies. For instance, Anheuser-Busch Corp. recently issued dual-currency Swiss franc and yen Eurobonds as well as standard Eurodollar paper. And such companies as Avon Products, Intel and McDonald's, are now old hands in the Euroyen market.

To be sure, there are still some gold nuggets for U.S. commercial banks abroad. They are the major players in foreign-exchange markets from London to Hong Kong, and they lead the field in currency and interest-rate swaps. Corporate money men also consider them much more innovative than the Europeans and Japanese in structuring complex financial packages. "As financial engineers, they are streets ahead of the competition," says Treasurer Ronald Bell of Industrial Equity Ltd., one of Australia's fastest-growing holding companies.

But even here the American banks are coming under pressure. Not only are rival banks elbowing their way further into these areas, but several investment banks—including Merrill Lynch and Japan's Nomura Securities and Daiwa Securities—have recently set up commercial banking subsidiaries in London. "With a bank in our group, we can handle our own forex and swap operations and indulge in some lending," says Andreas Prindl, chief executive of Nomura International Finance in London.

Increasingly, therefore, American bankers believe they must build up their investment banking business abroad if they are to survive over the long run. As one puts it: "Borrowing is clearly going out of fashion. Unless we take on the investment banks, we might just as well plod along and wait for a Japanese institution to come and gobble us up."

It's not going to be an easy ride. The leading American investment banks, Japanese securities giants and European universal banks are all powerful players with established positions in the Eurosecurities markets. And recent deals suggest that the highly liquid Japanese and German institutions are going to be just as tough to beat as their commercial banking counterparts. A sign of the times: Nomura Securities lead-managed more international corporate issues—a total of 85, worth $8.7 billion—than any other securities firm last year. Concludes Stefan Mendelsohn: "Unless the economic fundamentals shift back in the U.S. banks' favor, and quickly, they could find that their move into investment banking just gets them out of the frying pan and into the fire." ■

FADING FORTUNES

The U.S. banks' share of the international banking market has dropped sharply in just two years...

	Market Share*	
	1984	1986
Japan	32%	23%
U.S.	19	26
France	8	9
Germany	8	6
U.K.	7	8
Other	27	28

...as the dollar's role in international borrowing was declining.

	Share of Eurobond Market**	
	1984	1986
Dollar	60.4%	78.9%
DM	9.9	7.0
Yen	8.7	1.6
Sterling	7.6	5.8
ECU	4.8	3.6
Other	8.6	3.1

*Source: Bank for International Settlements. **Source: International Financing Review.

Congress Balks at Helping the Banks

The legislators will supply short-term help. But they refuse to face the thorny issue of expanded powers.

by John M. Barry

Every year since 1983, banking experts have made the same prediction: Congress would write sweeping new banking laws, since the rapidly changing marketplace has made the current ones obsolete. It didn't—and it won't this year either.

Few legislators want to antagonize such powerful interest groups as the banks, the brokers and the big companies that want a piece of the bank's once exclusive action. Whichever way they vote they will make enemies. Says New York Democrat Charles Schumer, a key member of the House Banking Committee: "Banking is like tax law, with a million interests each hammering on their own viewpoint, and the general interest vague and ephemeral."

Congress never handles hot potatoes that it doesn't have to. And rewriting the 1933 Glass-Steagall Act, which divided the turf between the banks and the brokers, is something the legislators are not eager to address. However, Congress will deal with those serious financial industry problems that are not postponable, such as beefing up the faltering Federal Savings and Loan Insurance Corp. and giving the regulators more powers to merge failing banks.

The measure that cleared the Senate Banking Committee last month by an impressive 12-to-6 vote provides $7.5 billion over two years for the beleagured FSLIC and beefs up the regulators' clout. The Administration had wanted to pour $15 billion into the FSLIC, but Congress typically prefers to keep it on a tight leash. Says Chairman William Proxmire of the Senate Banking Committee: "That should cover the situation for a while and give us a chance to see how it's working."

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Senate Banking Chairman William Proxmire: A populist who favors the small banks, he is determined to prevent further concentration of financial power

The Senate committee bill is very bad news for the big banks that want legal permission to enter new businesses. Even though the bill prohibits new nonbank banks, it does nothing to alleviate the banks' regulatory disadvantage, by freezing for one year any additional powers for them to engage in new businesses.

In the House, Banking Committee Chairman Fernand St. Germain also will ignore the Glass-Steagall quagmire and simply pass an FSLIC bailout. So when ultimately the two Houses get together, they are likely to deal only with the immediate crisis. Also likely to become law this year are a regulators' powers bill and a limit on the time

banks can take to clear checks, both of which are in Proxmire's bill. Still another possibility is a requirement that credit card issuers disclose their interest rates before signing up customers.

Congress' reluctance to face the turf question reveals the waning clout of the once powerful banking lobby. On this issue, the small banks have split with the big institutions and even the behemoths are divided. This disunity makes it easier for Congress to dodge the issue.

Most of the major banks want the right to enter other businesses, but they differ on giving the new financial services giants the same powers. Citicorp, Chemical Bank and Security Pacific and others last January joined with such companies as Sears, Roebuck, Merrill Lynch, General Motors Acceptance Corp. and American Express to form the Mayflower Group. The goal of this formidable lobbying organization, named for Washington's Mayflower Hotel where it first met, is to replace Glass-Steagall with "regulation by function."

Such a change would permit any business to operate financial service subsidiaries, and have these subsidiaries regulated according to what they did—not according to whether the services were provided by, say, a federally-chartered bank, a bank holding company, or a retailer. The idea was conceived originally by the securities industry and was endorsed by a White House task force three years ago when former Merrill Lynch Chairman Donald Regan was Treasury Secretary.

But functional regulation is strongly opposed by small and medium-sized and some big banks, which fear that they will be overwhelmed by such muscular competition. They have garnered political support by contending that functional regulation is a threat to the safety of deposits. "Maybe we ought to have functional realignment," says Schumer. "But until we agree on that, there shouldn't be further breaches in the wall [between business and banking]."

All the banks that want new powers, however, could get help from the Fed.

Congressman Schumer: So what "if the Chase Manhattans shrink"

Chairman Paul Volcker, who in the past strongly opposed breaching the Glass-Steagall wall, has recently become more sympathetic to the banks' plight.

Last month, in Volcker's absence, the Fed voted four-to-zero to authorize a unit of the Chase Manhattan Corp. to underwrite—as well as deal in—commercial paper. It has been expected to approve similar applications from Citicorp, J.P. Morgan and Bankers Trust, as well as their requests to underwrite municipal revenue bonds and to operate mutual funds. The Fed apparently assumes that the Banking Committee's one-year ban on expanded powers will not pass the Senate.

President Gerald Corrigan of the Federal Reserve Bank of New York has a plan to give banks expanded powers. He wants to write new definitions for bank and financial holding companies and commercial companies and would regulate them separately. This would permit banks to underwrite and trade stocks and bonds. And it would drive nonfinancial institutions, such as Sears and General Motors, out of the banking business.

Volcker hopes to come up with a Fed position on expanded powers and then sell it to Congress. But getting the Fed governors to agree won't be easy. The Reagan appointees to the central bank, who now constitute a majority, are out-and-out deregulators. So, in the end, the Federal Reserve may be too divided and Volcker powerless to secure new powers for the banks.

Meanwhile, the big banks that oppose nonbank banks are losing ground in Congress, which favors little banks and anything that is packaged as being pro-consumer. A case in point: Proxmire has long opposed nonbank banks, but Sears has lobbied effectively to keep them alive, arguing they offer more options to small consumers. This populist claim has hit home on Capitol Hill and Proxmire bowed to pressure and moved the date for grandfathering existing nonbanks from 1983 to 1987.

With the little banks beating the drum, both Proxmire and House Speaker Jim Wright are determined to structure any bill to prevent further concentration of financial power into the hands of the big banks. Both have a strong predilection for local banks and an antipathy to the money-center institutions. Proxmire maintains that the bulk of economic development is in small and medium-sized businesses and that while "big banks make 13% of their loans to these businesses, small banks make 90% of their loans to them. The vision some people have of the 14,000 banks shrinking to 1,000 or less is, to me, a nightmare," he adds.

Proxmire is equally indifferent to the loss to the Japanese of the money-center banks' once dominant world position. Indeed, he maintains that the Japanese banks have succeeded internationally because "they're smarter, more aggressive, and work harder. I don't think their bigness is the reason they do well," he says. And Schumer says he wants to maintain the international competitiveness of U.S. banks, but he isn't worried if "the Chase Manhattans shrink."

Legislators are very reluctant to antagonize the small banks, brokers and the financial services giants that are so important to filling their campaign chests. So many expect that an overhaul of the banking laws will be put off again—probably until 1989. But will that be soon enough to help? "It's urgent that Congress act," insists a prominent New York banker, "because the banks are getting further and further behind." ■

PHOTOGRAPH BY LARRY BARNS/BLACK STAR

How To Save the Banks

by Martin Mayer

Banks loom so large on the American commercial horizon that it's difficult for people—including Congressmen and bankers—to realize how serious their problems are. The pillars of their throne have been pulled out from under them; their lofty status has become a combination of levitation and habit, which can vanish any day.

Banks have been very nearly frozen out of lending to the largest corporations, they are no longer needed to make automobile loans, and they are paring their profits on mortgages by selling them off. "Middle market" business still relies on bank loans, but the commercial credit companies, insurers and factors are sharpening their pencils. Only Third World lending is still pretty much a banking monopoly, because nobody else wants it.

Everybody is invading traditional banking businesses. Mutual funds issue checkbooks; labor unions issue credit cards; Sears' Discover account pays interest on balances. Supermarkets own Automated Teller Machines; General Electric runs wire transfer networks for large banks; Automatic Data Processing services ATMs and Point-of-Sale registers for small ones.

Mismanagement of the international debt problem has saddled money-center banks with an interest-rate disadvantage that will cripple them for years. The regional banks will manage to escape from LDC debt by the end of this decade, but they must get their costs in line.

Right now, the banks are the high-cost providers of their main products. Knowing this, they want to supplement the old "low value-added" services with investment banking, which promises higher returns. But it's like the higher return on foreign lending: When you least expect it, the rewards prove to be for additional risks assumed, not for value added.

In the past, underwriting deals often went sour at the same time that commercial loans collapsed. That was the lesson of 1930-32—and the reason the Glass-Steagall Act took commercial banks out of underwriting. As long as the government insures deposits, Congress should not let the banks take on the risks of underwriting securities.

Similarly, banks shouldn't be allowed to package and sell long-term debt without an intermediary who is obliged to examine the paper and stand behind its legitimacy. Too often, banks have been tempted to unload the junk in their loan portfolios (as they got rid of Latin American loans through their securities affiliates in the late 1920s).

But banks should be freed from Glass-Steagall's unfair restrictions. Banks that manage "commingled funds" for trust accounts should be able to market those funds publicly. And they should be allowed to broker or underwrite commercial paper, which is just a packaged short-term bank loan.

Bank trust departments should be permitted to market their financial planning to anyone who comes in the door. There's no reason to believe banks can't put on their platforms advisers every bit as competent as the salesmen of, say, IDS.

And legislators should help them open up new fields for their labors. All kinds of insurance brokerage are suitable appendages to the banking floor. New York's savings banks have for generations written life insurance, which has been profitable for them and cost-effective for depositors; every bank should have the power to underwrite such actuarial risks.

Commercial banks can expand by exploiting the convenience of their existing facilities to sell different financial products. Banks should offer "full-service brokerage." They could do so now, if they registered their customers' men and women with the Securities and Exchange Commission as the brokers do and stopped fighting the SEC's supervision. Travel agenting meshes well with the operations of a consumer bank. And banks also could offer accounting services for small businesses and tax preparation for individuals.

Banks perform best in lending to the little guy—the dentist who needs an office chair or the electronics shop that wants to make a new kind of circuit board. Will, or can, the likes of the GECCs, Walter Hellers and Commercial Credits do as good a job holding small business' hands?

Fortunately, small business lending is profitable. And thoughtful big banks, like Security Pacific, are restudying their branch networks as sources of sound loans that pay high rates—not because they are riskier but because they cost more to make and service.

"Competitiveness," if it means anything at all, means eliminating unnecessarily costly financial services. The burden of proof is now on the banks to demonstrate that they can compete against alternative suppliers. And the government must get out of the way.

Martin Mayer is a New York journalist who writes frequently on banking

Transco Products Inc. by dint of his nine years of giving search jobs to Coopers & Lybrand. Burgman also has cultivated a half-dozen other top executive recruiting firms by presenting himself as a prospective client. "As someone who might give them business, they are usually happy to accept my invitation for lunch," he says. "That way, I was able to keep my face in front of them."

This strategy gives you the advantage of personally meeting with a recruiter without openly declaring that you are job hunting. David Smith, now president of Schindler Elevator Corp., for many years actively cultivated headhunters as a client of four different ones and as a source to numerous others. The payoff came when, while employed at American Standard, he received an unsolicited call from a recruiter that led to his current job. "I see my contacts with recruiters as my capital for my career," says Smith.

Like marriage, the role you play with a recruiter may change several times over the years. While you may view yourself as a job candidate, the recruiter thinks of you as source of information or as a valued client who will eventually hand the firm a $75,000 fee for finding an executive.

Chairman Max Ulrich of search firm Ward Howell International recalls placing an executive in a top human resources job last year, who was so pleased with the position that he promptly gave the firm a $400,000 search. "Clients become sources, sources become candidates and candidates become clients along the way," observes James J. Drury III a top recruiter at Spencer Stuart.

Once you have established a relationship with a recruiter, work to keep it going. One of the best ways to do so is to provide the recruiter with good leads to executive talent. "Cooperate if you are called to recommend others for a job," advises Jane Evans, former president of General Mills' Monet Jewelers unit and currently a partner at Montgomery Securities.

But this strategy is only as effective as the quality of the talent you bring to the recruiter's attention. Advises John Burgman, who has long acted as a source for recruiters: "It's better to say I don't know than to give a recruiter a bad lead." Indeed, Charles W. Kepler, head of search firm Russell Reynolds' Chicago office notes, "We don't forget sources who give us outstanding leads." According to Kepler, Russell Reynolds actually "calibrates sources" according to the quality of their recommendations.

Recruiters often add to their lists prominent people in major business disciplines. So while you are pursuing all these strategies you should try to increase your visibility. Here are some of the roads to a higher profile suggested by recruiters:

☐Get your company's public relations department to issue a release on any promotion or award. If that's not possible, notify your university alumni magazine and any trade associations of which you are a member.

☐Write articles for trade publications.

☐Join and take a leadership role in an industry association, college alumni group, or charity.

☐Cultivate people in the media. It never hurts to be on the 6 o'clock news as the expert explaining tax reform or why health care costs are escalating.

If all else fails, there is always the unsolicited letter approach. Do not send a picture and absolutely never send a video-cassette recording of yourself. While you might think you're the picture of the successful executive, the headhunter may not agree. James R. Arnold, head of executive search at A.T. Kearney, Inc., chuckles as he recalls outlandish plaid sports jackets, stiff presentations and candidates who resemble snake oil salesmen. "We've received some very amusing videos," he smiles.

Getting on a headhunter's list is much like scoring in a singles bar. "You have to project yourself as a winner—someone the recruiter really wants to get to know," advises Russell Reynolds' Kepler. —L.A.

INVESTMENT UPDATE

Here's the current status of a number of investments, and a look at how they have fared over the past month and the past year.

INVESTMENT	(2/27/87) Recent Price or Yield	Value of $10,000 if invested: Month Earlier	Year Earlier
Common Stock (Index fund, capital gains and dividends reinvested)	$28.58/share	$10,396	$12,867
per cent change		+4%	+28.7%
Bonds (30-yr., 11¾% Treasury Bond)			
MARKET VALUE	$142.50	$10,460	$11,182
ACCUMULATED INCOME		$ 71	$ 922
TOTAL		$10,531	$12,104
per cent change		+5.3%	+21%
Money Market Fund	5.33%	$10,040	$10,597
per cent change		+0.4%	+6%
Gold (Krugerrands)	$410.00/oz.	$10,024	$12,058
per cent change		+0.2%	+20.6%
HOUSE PRICES	Recent	Month Earlier	Year Earlier
Existing House	$112,400	$105,200	$100,000
per cent change		+6.8%	+12.4%
New House	$132,600	$133,400	$112,000
per cent change		0.6%	+18.3%

Sources: Vanguard Group Inc.; Salomon Brothers; Donoghue's Money Fund Report; Manfra, Tordella & Brookes,Inc.; Federal Home Loan Bank Board.